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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 59

REO MOTORS, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 191–200) are reported at 9 T. C. 314. The opinion of the Court of Appeals (R. 216–223) is reported at 170 F. 2d 1001.

JURISDICTION

The judgment of the Court of Appeals was entered on November 29, 1948 (R. 216), and rehearing was denied February 1, 1949 (R. 235). The petition for a writ of certiorari was filed April 25, 1949, and was granted June 6, 1949

(R 235). The jurisdiction of this Court rests upon 28 U. S. C., Sec. 1254.

QUESTION PRESENTED

Whether Section 23 (g) of the Internal Revenue Code (governing deduction for capital losses) as applicable to the year 1941, or that section as amended and applicable to the year 1942, should be applied in computing net operating loss for 1941 which may be carried over to, and deducted in, 1942 under Sections 23 (s) and 122 of the Code.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra*, pp. 68–79.

STATEMENT

The facts are undisputed, being reflected in a stipulation of facts and exhibits. (R. 192.) The pertinent facts were summarized by the Tax Court (R. 192–195) and may be restated as follows:

Taxpayer, a corporation, was organized on January 2, 1940, under the laws of the State of Michigan. It is engaged in the business of manufacturing motor vehicles and has its principal office at 1331 South Washington Avenue, Lansing, Michigan. Its income and declared value excess profits tax returns and excess profits tax return for the calendar year 1942 were prepared on an accrual basis. (R. 192.)

In January, 1940, taxpayer acquired all the shares of stock of Reo Sales Corporation (here-

inafter referred to as "Reo Sales"), a sales agent for taxpayer. Thereafter, until the dissolution of Reo Sales, all of its stock was owned directly by taxpayer. Taxpayer's adjusted basis for determining gain or loss from the sale or other disposition of such stock was $1,551,902.79. (R. 192.)

More than 90 percent of the aggregate of the gross income of Reo Sales for all taxable years was from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchange of stocks and securities. (R. 192.)

During the calendar year 1941, Reo Sales was dissolved and as of February 1, 1941, all of its assets, subject to all its liabilities, were transferred to taxpayer. On February 1, 1941, Reo Sales was indebted to taxpayer in the sum of $1,263,707.57, while the net value of the assets taxpayer received upon the dissolution of Reo Sales was $1,048,219.95. (R. 193.)

Taxpayer received no compensation for any loss sustained by it on the dissolution of Reo Sales. For the difference between Reo Sales' indebtedness to taxpayer and the net value of the assets taxpayer received upon the dissolution of Reo Sales, amounting to $215,487.62, taxpayer claimed and received a bad debt deduction in 1941. Taxpayer's loss with respect to the stock of Reo Sales (which had an adjusted basis of $1,551,902.79) was a long-term capital loss under the law applicable to the taxable year 1941. It

was so claimed by taxpayer in its 1941 return and the deduction was allowed by the Commissioner. (R. 193.)

Taxpayer's gross income for 1941 was $2,573,259.89. Including the bad debt deduction of $215,487.62 referred to above, but not including any deduction with respect to the stock of Reo Sales, any deduction for depletion, any net operating loss deduction, or any deduction for losses from sales or exchanges of capital assets, the deductions allowable to taxpayer for 1941 by chapter 1 of the Internal Revenue Code amounted to $2,215,727.08, which is less than taxpayer's 1941 gross income. (R. 193.) With the addition of the $1,551,902.79 loss in respect of the Reo Sales stock, taxpayer would have had a net loss for 1941.

During 1941, taxpayer realized no gain from the sale or exchange of capital assets, received no interest which was wholly exempt from the tax imposed by chapter 1 of the Code, and did not pay or accrue any tax imposed by subchapter E of chapter 2 of the Code (the excess profits tax). (R. 193.)

For the following year, the taxable year 1942, taxpayer's net income was $1,926,136.34, computed without allowance of a net operating loss deduction and without any depletion deduction. Taxpayer's normal tax net income for 1942 was $1,926,102.34 computed without any net operating

loss deduction and without the credit provided in Section 26 (e) of the Internal Revenue Code. For the year 1942, taxpayer received no interest exempt from the taxes imposed by chapter 1 of the Internal Revenue Code, received no interest for which a credit was provided under Section 26 (a) of the Code, and realized no gains and sustained no losses from sales or exchanges of capita assets. (R. 193–194.)

In computing taxpayer's net income for 1942, the Commissioner did not allow any net operating loss deduction, as claimed by petitioner (R. 194.) In his letter accompanying the deficiency notice he explained this action as follows (R. 194–195):

> The net loss for the year 1941 resulted chiefly from the deduction of an amount of $1,552,248.16 from the worthlessness in 1941 of your investment in the stock of a subsidiary. This stock was a capital asset under the Internal Revenue Code for 1941 and constituted a capital loss in 1941 and was allowed as a long term capital loss, deductible without limitation as claimed in your return for the year 1941. In computing the amount of the net operating loss deduction claimed in 1942 you included therein as part of the net operating loss carry-over from 1941 the loss of $1,552,-248.16 sustained by you in 1941 on the stock of the subsidiary. You contend that under Section 23 (g) (4) of the Internal Revenue

> *Code as amended by the Revenue Act of 1942* the loss on dissolution in 1941 of your wholly owned subsidiary company is not a capital loss for the purpose of determining the 1941 net operating loss deduction carried over to 1942.
>
> It is held that the net operating loss deduction allowable for the year 1942 is to be determined under the Internal Revenue Code as it existed in the year in which the net operating loss was sustained. Therefore, under the Internal Revenue Code in effect for the year 1941, the capital loss of $1,552,248.16 sustained upon dissolution of your subsidiary company is not allowable as a deduction in determining the net operating loss carry-over to the year 1942 [Italics supplied].

This determination of the Commissioner was sustained by the Tax Court (R. 195–200), and the decision of the Tax Court was affirmed on appeal by the Court of Appeals for the Sixth Circuit (R. 216–223).

SUMMARY OF ARGUMENT

A. Section 23 (s) of the Internal Revenue Code authorizes the deduction from gross income of the net operating loss deduction as computed under Section 122 of the Code. Under Section 122, the net operating loss deduction for the taxable year consists of the sum of the carry-backs and carry-overs to that year of net operating losses of other years, with certain adustments. The net

operating loss of any given year consists of the excess of deductions for that year over gross income for that year, with certain exceptions and limitations. In general, such a net operating loss is first carried back to the two preceding taxable years in succession (but never beyond 1941), and offset against income in those years; any remainder is then carried over to the two succeeding years and similarly offset. The entire mechanism thus consists of three parts, which are separate and distinct, and, as we shall show, are generally governed by the laws of different years: (a) the "net operating loss" sustained in a given year; (b) "the net operating loss carry-back" and "carry-over" which transfer the net operating loss to other years; and (c) the "net operating loss deduction" which constitutes the mode of actual deduction of a loss in another year. Congress' general purpose in adopting this device was to achieve approximate equality in the incidence of income taxation as between businesses with steady earnings and those with alternating profits and losses; relief is granted the taxpayer with widely fluctuating earnings by requiring, in effect, the payment of the tax only on the average of income over a period of years.

B. Taxpayer claims a net operating loss deduction *in 1942* based upon the contention that it had a net operating loss *for 1941*. It had a net operating loss for 1941 only if the loss it sustained in 1941 on the liquidation of Reo Sales

was an ordinary, rather than a capital, loss. The loss was an ordinary one under the law applicable to 1942, because paragraph (4) (as added to the Code by the Revenue Act of 1942) of Section 23 (g) (governing the deduction for capital losses) made it so, but it was admittedly a capital loss under the previous law applicable in and to 1941. Taxpayer contends that the amended Section 23 (g) (4), concededly not applicable in computing tax liability for 1941, is nevertheless applicable in computing net operating loss for 1941, for the purpose of a carry-over net operating loss deduction in 1942. This contention is similar to that made by the taxpayer in *Commissioner* v. *Moore, Inc.*, 151 F. 2d 527 (C. A. 5) (affirming 4 T. C. 404), and there upheld in a decision which we believe to be erroneous and in flat conflict with the holding below. The full Tax Court, in deciding the instant case, attempted to distinguish its earlier decision (which was by a single judge), but the distinction seems to us entirely unsubstantial, as the Tax Court judge who decided the *Moore* case indicated by dissenting here.

C. Under Section 101 of the 1942 Act, the amended Section 23 (g) (4) is applicable "only with respect to" taxable years beginning after December 31, 1941, and therefore is *not* applicable "with respect to" 1941. But it is clearly "with respect to" 1941 that taxpayer seeks to apply Section 23 (g) (4), since the computation

of net operating loss for 1941 is involved. Accordingly, as the court below held, Section 101 of the 1942 Act is a complete answer to taxpayer's argument. Contrary to its contention, the fact that the case concerns the computation of tax liability for 1942, rather than for 1941, cannot serve to make the amendment applicable in the computation of net operating loss for 1941, and thus "with respect to" 1941, when Congress has provided that the amendment governs only "with respect to" 1942 and following years. Nor is taxpayer's position supported by the fact that the Revenue Acts from 1924 to 1932, in allowing a similar net loss deduction, expressly provided that net loss for an earlier year should be computed in accordance with the law applicable to that earlier year. Section 101 of the 1942 Act has the same effect as to the amended Section 23 (g) (4) on which taxpayer relies. The difference in form is explainable by the fact that the pre-Code revenue acts were all self-contained, and effective only until a new act was adopted, after which the law of a prior year could not control for any purpose unless it was expressly so provided. The Internal Revenue Code, on the other hand, has continuous application and, upon amendment, old provisions remain in effect for past years, unless provision is made to the contrary.

D. Moreover, Section 122—the portion of the Code governing net operating loss, carry-overs

and carry-backs, and the net operating loss deduction—reflects the intention of Congress that, as under the earlier Revenue Acts allowing a net loss deduction, net operating loss for a given year must be computed according to the law applicable to the year in which the loss is sustained. Section 122 (a) defines "net operating loss" as meaning the excess of deductions "allowed by this chapter" over the gross income, with certain exceptions and limitations provided in subsection (d). The deductions "allowed by this chapter" for a given year are the deductions allowed under the law applicable to that year for the purpose of computing tax liability for that year. The exceptions and limitations provided in subsection (d) are, of course, applicable to any given year according to whether they have been made applicable to that year. Thus, the very terms of Section 122 (a) require the computation of net operating loss for a given year to be computed according to the law applicable in the computation of tax liability for that year (with the exceptions and limitations provided in subsection (d) and applicable to that year), and there is no basis for the decisive distinction which taxpayer attempts to draw between the law applicable in computing tax liability for 1941 and the law applicable in computing net operating loss for 1941 (which is to be deducted in 1942). Net operating loss is computed under the law governing the year of loss, although the law of prior or

later years will determine the extent to which this net operating loss, if any, is to be carried-over or carried-back, and the extent to which it may be deducted in another taxable year.

The terms of Section 122, and its legislative history, likewise prove that the net operating loss will be a fixed amount, not subject to annual fluctuation. Under taxpayer's contention, the amount of net operating loss for a given year would have to be computed according to the law applicable to the year or years in which a taxpayer seeks to carry-over or carry-back net operating loss of another year and obtain a deduction therefor. The amount of net operating loss for a given year could therefore vary from year to year, depending upon the law applicable to each of the years to which net operating loss is sought to be carried-over or back, and deducted. This lack of a fixed amount of net operating loss for a given year would produce results in conflict with the Congressional intent and the structure of the net operating loss provisions.

In addition, the Congressional purpose in adopting this mechanism was, as stated above, to permit taxpayers having an excess of deductions over gross income in one or more years to offset that excess, or loss, against net income of other years, and thereby to grant relief from fluctuating earnings by requiring the payment of tax only on the average of income over a span of years. On petitioner's theory, this purpose of

achieving approximate equality between businesses with steady profits and those with fluctuating earnings cannot be effectuated. In some cases, a taxpayer would receive an extra deduction in a subsequent or prior year which other taxpayers operating without loss would never receive. In other cases, a taxpayer who actually had a net operating loss in a given year would not be able to carry-over or carry-back that loss to another year and receive a deduction therefor. On the other hand, when net operating loss for a given year is computed in accordance with the law applicable to that given year, and the deductions taken into account in computing net operating loss for the given year are the deductions allowed under the law applicable to that year, net operating loss for the given year consists of a fixed amount susceptible to offset against net income of other years in effectuation of the Congressional purpose to attain general equality of income tax incidence.

Petitioner's arguments for the application of the 1942 change in Section 23 (g) in computing net operating loss for 1941 all disregard the basic structure of the net operating loss provisions of the Code, as well as the distinction between the computation of net operating loss itself and the determination of the extent to which that loss is to be carried-over (or carried-back) and deducted in another year. Moreover, taxpayer's arguments for reversal build in large measure

upon the foundation-premise that the decision in *Commissioner* v. *Moore, Inc., supra,* p. 8, is correct, a conclusion which can only be accepted after the conflicting decision below is shown to be wrong.

ARGUMENT

Taxpayer's net operating loss for 1941 must be computed according to the law applicable to 1941, and, accordingly, taxpayer had no 1941 net operating loss which it could carry over to and deduct in 1942 as a net operating loss deduction under sections 23 (s) and 122 of the Internal Revenue Code

For several years, the Internal Revenue Code has permitted taxpayers computing their income tax for a given year to carry over, in the form of a deduction from that year's gross income, a net operating loss suffered in the prior year or two, and also to carry back, in the same form of a deduction from the taxable year's gross income, a net operating loss incurred in a subsequent year. In this way, Congress has sought to equalize the incidence of income taxation as between businesses with stable incomes and those with alternating profits and losses; relief is granted to the taxpayer with widely fluctuating earnings by requiring, in effect, the payment of the tax only on the average of income over a period of years.

The general question presented here is whether this net operating loss—which is carried over to a later year and then deducted, or, as the case may be, carried back and deducted in an earlier year—is normally to be computed under the terms

of the tax statutes in effect at the time the alleged loss was actually incurred, or pursuant to the legislation in effect at the later (or earlier) time to which the loss is carried and taken as a deduction. In this case, the Tax Court and the Court of Appeals for the Sixth Circuit have held that petitioner's net operating loss for 1941 (if any) is to be computed under 1941 law, rather than under the statutes applicable to 1942 when the deduction was claimed. Petitioner and the Fifth Circuit, in a substantially identical case (*Commissioner* v. *Moore, Inc.*, 151 F. 2d 527, affirming 4 T. C. 404), take the other view.[1]

We agree with the Sixth Circuit and the Tax Court that petitioner's net operating loss, which is sought to be carried-over to 1942, must be calculated in accordance with the law applicable to the year in which the loss, if any, was suffered, and not that governing the year in which it is ultimately deducted. This position is compelled, in our view, by the terms, purpose, structure, and

[1] The Tax Court, in its opinion in the instant case, attempted to distinguish the *Moore case*, rather than reject it, but, as we point out below (*infra*, pp. 64–66), we believe the distinction to be entirely unsubstantial, and that the present case cannot stand together with *Moore*. It is also true that the Tax Court's *Moore* opinion adopted the present petitioner's view, but it is appropriate to note that the *Moore* decision was rendered by a single one of the Tax Court's sixteen judges, and was not reviewed by the full court. In contrast, the Tax Court's present opinion was reviewed and accepted by the full court, with a sole dissent from Leech J., who believed that the matter was controlled by the *Moore* case which he had decided.

history of the carry-over and carry-back provisions of the Internal Revenue Code. And we are not moved in our construction of the statutes by a desire to increase the Federal Government's revenue. For there is no way of telling whether the Commissioner's interpretation will bring greater sums to the Treasury than petitioner's; in some cases the tax will be larger if computed according to the provisions in effect when the loss was suffered, but in others it will be much less than if later (or earlier) provisions are used. Cf. *Cambria Collieries Co.* v. *Commissioner*, 10 T. C. 1172.

A. The general operation and purposes of the net operating loss provisions of the Code

1. The net operating loss provisions of the Internal Revenue Code (Section 122, Appendix, *infra*, pp. 70–74) operate, in general, in the following way. Section 122 (a) defines a net operating loss as the excess of the deductions normally allowed by the Code's income tax chapter over gross income, with certain specified adjustments. Such a net operating loss may be carried back (under subsections (b) and (c)) to the two preceding taxable years and may also be carried forward to the two succeeding years, and in effect used to offset income in those prior and subsequent tax years. The net operating loss is first carried back to the second preceding taxable year and used to offset whatever income the taxpayer had in that year. Any remainder of the

net operating loss is then carried back to the first preceding taxable year and employed to offset income in that year. The part of the loss not used up in the first and second preceding taxable years may then be carried over to the first succeeding tax year and then to the second year. For example, a net operating loss sustained in 1943 is first carried back to 1941; then it is carried back to 1942; third, it is carried over to 1944; and, last, it is carried over to 1945. No net operating loss, however, may be carried back to a taxable year which began prior to January 1, 1941. Petitioner's asserted loss for 1941 could, therefore, not be carried back to 1939 or 1940, but would first be carried over to 1942.

Thus, the net operating loss mechanism may be divided into three parts. There is, first, the *net operating loss* sustained in a given year. Second, there is the *net operating loss carry-back* and *carry-over;* the carry-back and the carry-over are the means by which the net operating loss of one year is carried to a prior or subsequent year, and made available in the prior or subsequent year as an offset against income. Lastly, there is the *net operating loss deduction,* which is the sum of the carry-backs and carry-overs to a given year, with certain adjustments. The net operating loss *deduction* is the vehicle by which net operating losses incurred in prior or later years, and carried to the given year by means of carry-overs and

carry-backs, are directly taken into account in determining the net income for the given year.

2. The general purpose of the net operating loss provisions is to permit the averaging of income and losses over a five-year period, and thereby afford tax relief against fluctuating earnings. Through the use of this device a tax is paid only on the net operating income spread over the entire period. See *Dalton* v. *Bowers*, 287 U. S. 404, 408. In 1939, Congress readopted carry-overs, after a six- or seven-year interval, with this end specifically in view.[2] In 1942, the Code was amended to provide for the carry-back, as distinguished from the carry-over. S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 51–52 (1942–2 Cum. Bull. 504, 546–547) reflects that a main purpose of the carry-back provisions, under which a 2-year carry-back was allowed, was to afford the same relief in periods of declining profits as was afforded for periods of increasing profits under the carry-over provisions.[3]

Stated somewhat differently, the purpose of Congress was to permit a taxpayer without suffi-

[2] The House Committee on Ways and Means stated (H. Rep. No. 855, 76th Cong., 1st Sess., p. 9 (1939–2 Com. Bull. 504): "As a result of the elimination of this carry-over, a business with alternating profit and loss is required to pay higher taxes over a period of years than a business with stable profits, although the average income of the two firms is equal. New enterprises and capital-goods industries are especially subject to wide fluctuation in earning * * *."

See also *infra*, fn. 34, pp. 46–47, for further excerpts from the Committee's report.

[3] See *infra*, fn. 34, pp. 46–47.

cient gross income in a given taxable year to take advantage of all its allowable deductions *for that year,* to obtain the benefit of the excess of *these* deductions in a prior or subsequent year. By this means, general equality in tax payments was to be secured between businesses with stable earnings and those with alternating profits and losses, since the former were normally able to get the benefit of their deductions each year.[4]

B. Taxpayer's claim:—That a 1942 amendment to Section 23 (g) of the Code (governing deduction for capital losses) applies in determining the net operating loss for 1941 which is carried over to 1942

1. In outline, taxpayer's particular claim for a net operating loss deduction in 1942 is this:— Under the statutory provisions in effect in 1941, Reo Motors admittedly did not have a net operating loss, because its loss on the liquidation of its subsidiary was then characterized as a capital loss which taxpayer could not deduct from gross income in computing net operating loss; if the loss were deductible, a clear net operating loss would have resulted. In 1942, Congress amended the Internal Revenue Code to remove similar stock losses on the liquidation of a sub-

[4] On the purpose, history, and general operation of the net operating loss provisions of the Code, see L. Raum, *Carry-overs and Carry-backs of Net Operating Losses and Unused Excess Profits Credits*, Part 16 of Practical Aspects of Federal Taxation (The Bureau of National Affairs, 1946); L. Raum, *Carry-overs and Carry-backs in Connection with the Liquidation or Sale of a Business*, (1949) 49 Col. L. Rev. 49, 49–54.

sidiary from the capital loss category, thus permitting a taxpayer to deduct such a loss from gross income in computing its net operating loss. Because of this 1942 amendment, petitioner insists that, in the course of computing its 1942 tax liability, it may establish for the first time a 1941 net operating loss, by deducting the stock loss, thus retroactively obtaining a net operating loss for 1941, which may then be carried over to 1942, and deducted from its 1942 gross income.

To spell out the claim more in detail:—Taxpayer seeks a deduction from gross income for the taxable year 1942 under Section 23 (s) of the Internal Revenue Code (Appendix, *infra*, p. 69) which authorizes the deduction of "the net operating loss deduction computed under section 122." Section 122 (c) (Appendix, *infra*, pp. 71–2) provides that—

> The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, * * * in the case of a corporation, the normal-tax net income (computed without such deduction * * *)

Net operating loss carry-backs and carry-overs are authorized by Section 122 (b) (Appendix, *infra*, pp. 70–71) and consist, as we have pointed out, of a taxpayer's net operating losses for cer-

tain prior and subsequent years which are then carried back or carried forward to another year and offset against income. The net operating loss deduction is the aggregate of the pertinent carry-overs and carry-backs to the particular taxable year. *Supra*, pp. 15–17.

Taxpayer's assertion of a net operating loss deduction in 1942 is based solely upon the contention that it had a net operating loss carry-over to 1942, consisting of a net operating loss in 1941. Whether taxpayer in fact had a net operating loss in 1941 turns upon the provisions of Section 122 (a) (Appendix, *infra*, p. 70) which defined the term "net operating loss" to mean—

> the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).[5]

Because of the adjustments provided in subsection (d), the fact that a taxpayer's deductions exceed gross income for a given year, with a resulting net loss, does not mean necessarily that the taxpayer has a "net operating loss" for that year within the meaning of Section 122 (a).

In the present case, the pertinent exception and limitation provided in subsection (d) is that contained in paragraph (4). See Section 122 (d)

[5] Section 105 (e) (3) (A) of the Revenue Act of 1942 (Appendix, *infra*, p. 75) amended Section 122 (a) of the Code to read "with the exceptions, *additions*, and limitations provided in subsection (d)" (italics added). This amendment has no relevance to the issues presented in this case.

(4), Appendix, *infra*, p. 73. That paragraph provided, in 1941, that long-term capital losses and short-term capital losses were deductible from gross income only to the extent, respectively, of includible long-term capital gains and short-term capital gains.[6] Taxpayer admittedly had no long-term or short-term capital gains in 1941. Hence, in computing its "net operating loss" for 1941, it cannot deduct any capital loss from its 1941 gross income.[7] And the $1,551,902.79 loss which peti-

[6] This provision illustrates that all deductions allowable in computing net income are not allowable for the purpose of computing net operating loss, and that a taxpayer having a *net loss* may not necessarily have a *net operating loss* subject to carry-over and deduction in a following year. Section 122 (d) (4) limits the deduction of long-term capital losses for the purpose of computing net operating loss. Section 117 (d) (Appendix, *infra*, p. 69), on the other hand, placed no restriction on the deduction of long-term capital gains for the purpose of computing net income subject to tax in 1941. See *infra*, pp. 38–39.

[7] This would also clearly be true if one were to apply paragraph (4), as amended effective only with respect to taxable years beginning after December 31, 1941 (Appendix, *infra*, p. 73), since that amendment merely did away with the separate treatment of short-term and long-term capital losses, making losses of either type deductible to the extent of capital gains of either type—of which taxpayer had none. *Supra*, p. 4.

For the purposes of its general argument, petitioner insists that the 1942 amendment to section 122 (d) (4) does apply here. We show below that, on the contrary, this 1942 amendment does not govern in computing net operating loss for 1941, and that petitioner's contention, which is the base for a large part of its argument, is incorrect. *Infra*, pp. 60–66. We also point out that, as stated above, petitioner gets no comfort from the 1942 change in section 122 (d) (4), even if it applies to this case. *Infra*, pp. 62–64.

tioner sustained in 1941, by reason of the fact that the Reo Sales stock it owned became worthless upon the dissolution of Reo Sales in that year, was a long-term capital loss under Section 23 (g) of the Code in effect in 1941 (Appendix, *infra*, p. 68)—a fact which taxpayer has conceded by stipulation. (R. 57–58.) The necessary result is that, if the law applicable to 1941 applies in computing taxpayer's net operating loss for 1941, taxpayer had no 1941 net operating loss to carry over to, and deduct in, 1942 as a net operating loss deduction.[8]

Taxpayer contends, however, that its loss on the Reo Sales stock is to be treated as an ordinary rather than capital loss, despite the law in effect in 1941. If this contention were correct, Section 122 (d) would not preclude the deduction of the loss from 1941 gross income in computing net operating loss for 1941, and the taxpayer would apparently have an excess of deductions over gross income, or a net operating loss, of $1,194,369.98 for 1941, and therefore a net operating loss carry-

[8] The facts bearing on the other exceptions and limitations provided in Section 122 (d) were stipulated (cf. Statement, *supra*, pp. 3–5, with Section 122 (d)) and the only figures to be considered in determining whether taxpayer had a net operating loss in 1941, which it may carry over to and deduct in 1942, are (i) its 1941 gross income of $2,573,259.89, (ii) the $1,551,902.79 loss on the Reo Sales stock, and (iii) its other allowable deductions totalling $2,215,727.08 (R. 57–59). The other deductions of $2,215,727.08 are, of course, less than taxpayer's 1941 gross income of $2,573,259.89, and therefore insufficient to establish a net operating loss.

over of that amount to 1942, which is deductible in 1942 as a net operating loss deduction.[9]

This argument that taxpayer's 1941 loss on its Reo Sales stock is to be considered an ordinary loss in computing net operating loss for 1941 is based upon the fact that the Revenue Act of 1942 (Section 123 (a) (1), Appendix, *infra*, pp. 68–9, 76) amended Section 23 (g) of the Code (deduction of capital losses) by adding a paragraph, number (4), which qualified Section 23 (g) (2) by providing that worthless stock of an affiliated corporation shall not be deemed a capital asset.[10] Reo Sales was admittedly an affiliated corporation within the requirements of this 1942 amendment, and application of the amendment would require the conclusion that taxpayer's 1941 loss on the Reo Sales stock was an ordinary and not a capital loss. It would then follow that the loss could be taken into consideration in the computation of net operating loss for 1941 which could properly be carried over to 1942, *Supra*, pp. 20–22.

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[9] The figure of $1,194,369.98 represents the difference between taxpayer's 1941 gross income of $2,573,259.89 and the combined total of the $1,551,902.79 loss on Reo Sales stock and taxpayer's other deductions of $2,215,727.08. See fn. 8, *supra*.

[10] Section 23 (g) (4) [as added by Section 123 (a) (1) of the 1942 Act] was amended slightly by Section 112 (a) of the Revenue Act of 1943, Appendix, *infra*, p. 79. The amendment was made applicable by Section 112 (c) of the 1943 Act (Appendix, *infra*, p. 79) to taxable years beginning after December 31, 1941, but it is of no importance in the present case.

In exact focus, the question in the case, therefore, is whether the 1942 Section 23 (g) (4) shall be applied in the computation of net operating loss for 1941, which is to be carried over and deducted in 1942. The answer, we believe, must be negative, if one is to follow the available indications of Congressional meaning:—the precise words of the statute, the history and structure of the carry-over provisions, and the plain legislative purpose.

2. Petitioner's claim is substantially the same as that of the taxpayer in *Commissioner* v. *Moore, Inc.*, 151 F. 2d 527 (C. A. 5), affirming 4 T. C. 404, and its arguments follow in large measure those accepted in that case (Pet. Br. 19, 21–2, 26, 31–38). The *Moore* case also involved the limitation contained in Section 122 (d) (4) of the Code with respect to the computation of net operating loss, as does the present case, but in a different way. The taxpayer there had a long-term capital loss of $17,025 and short-term capital gains of $2,844 in 1941. Under Section 122 (d) (4), as it stood in 1941, long-term capital losses were deductible in the computation of net operating loss only to the extent of long-term capital gains, and short-term capital losses were deductible only to the extent of short-term capital gains. Under Section 122 (d) (4) as amended by Section 150 (e) of the 1942 Act (Appendix, infra, p. 73, fn. 5), the

distinction between short-term and long-term capital gains and losses was withdrawn and a capital loss of either type was made deductible to the extent of capital gains of either type. (See fn. 7, *supra* p. 21.) The taxpayer in the *Moore* case contended that the amended Section 122 (d) (4) was applicable in computing net operating loss for 1941 for carry-over purposes to 1942, and, accordingly, that its long-term capital loss of $17,025 could be partially offset against its short-term capital gain of $2,844. As in the instant case, the amendment was applicable only "with respect to" the year 1942 and thereafter, by virtue of Section 101 of the 1942 Act. *Infra,* pp. 26–34; Appendix, *infra,* p. 74. The Tax Court and the Court of Appeals for the Fifth Circuit nevertheless upheld the taxpayer's contention that the amended Section 122 (d) (4) was applicable in the computation of net operating loss for 1941. As indicated in the beginning of our argument (*supra,* p. 14), it is our opinion that the reasoning of the *Moore* decision is flatly in conflict with that of the court below, and should not be followed. The Tax Court attempted to find a verbal distinction between the cases, but, as we shall show, there is no substance to its line of cleavage. *Infra,* pp. 64–66; fn. 1, *supra,* p. 14. The arguments we present here will, therefore, also serve to show the incorrectness of the Fifth Circuit's earlier holding.

C. The Revenue Act of 1942 expressly limits the effect of the 1942 amendment to Section 23 (g) to the 1942 tax year and thereafter, and the amendment therefore does not apply in computing a net operating loss for 1941

1. The court below properly held that Section 101 of the Revenue Act of 1942 (Appendix, *infra,* p. 74) furnishes a complete answer to the question whether the 1942 addition of paragraph (4) to Section 23 (g) is applicable here. (R. 219–220.) Section 101 of the 1942 Act states that—

> Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.

Section 123 (a) (1) of the 1942 Act—the section which added paragraph (4) to Section 23 (g)—contained no express provision relative to the years to which the amendment was applicable. Accordingly, as taxpayer admits (Pet. Br. 10, 35), Section 23 (g) (4) is "applicable," under Section 101 of the 1942 Act, "only with respect to taxable years beginning after December 31, 1941," which means, of course, that the amendment is *not* "applicable with respect to" the year 1941. Taxpayer further concedes, as it must, that, by virtue of Section 101 of the 1942 Act, Section 23 (g) (4) of the Code is not applicable to 1941 for the purpose of computing tax liability for that year. (Pet. Br. 38.)

However, in support of its contention that the 1942 law is applicable in calculating net operating loss for 1941, petitioner advances the argument

that Section 101 of the 1942 Act means that all amendments made by that Act may be applied *"in computing a tax liability for"* 1942, with the result that since it is the computation of tax liability for 1942 which is involved, and which in turn involves the computation of net operating loss for 1941, the computation of net operating loss for 1941 should be made according to the law applicable to 1942 (Pet. Br. 30–38, esp. 34).[11]

As the court below stated (R. 220), there is a substantial difference between the phrases "with respect to" and "in computing a tax liability for." "With respect to" ordinarily means "with reference or relation to," "pertaining to" (*International Milling Co.* v. *United States*, 89 C. Cls. 128, 137), or, to quote a familiar authority in these matters, "as regards, with reference to, as to". Webster's *New International Dict.* (2d ed.), p. 2123. To interpret Section 101 as requiring the application of 1942 law "in computing a tax liability for" 1942, *including the computation of net operating loss for 1941,* is equivalent to requiring 1942 law to be used, contrary to the statute's express language, in matters "with respect to", "with reference or relation to", "per-

[11] This contention was initially accepted by Judge Leech in his Tax Court decision in *Moore, Inc.* v. *Commissioner*, 4 T. C. 404, and was adopted by the Fifth Circuit in its affirmance of that decision. 151 F. 2d 527. The reasoning was rejected by the Tax Court in the instant case (R. 198–199), and in *Cambria Collieries Co.* v. *Commissioner*, 10 T. C. 1172, as well as by the Court of Appeals below (R. 219–220). See also *supra*, pp. 14, 24–25, and *infra*, pp. 60–66.

taining to", "as regards", or "as to" taxable years prior to 1942.

For it is plainly "with respect to" *1941* that the taxpayer seeks to apply a statute applicable *only* "with respect to" 1942. The case, of course, involves the computation of tax liability for 1942, but the point at issue is the law applicable in computing net operating loss for 1941. The event on which the claim of loss is grounded—of liquidation of Reo Sales—occurred in 1941, and it is the net operating loss for 1941 which taxpayer is seeking to use for a deduction in the later year. Its claim is that Section 23 (g) (4) should be applied in determining whether its 1941 loss on the Reo Sales stock was a capital or ordinary loss for the purpose of deciding whether it had a net operating loss for 1941. Stated another way, taxpayer is claiming that Section 23 (g) (4), as added in 1942, retroactively converted a capital asset into a noncapital asset, and thus a capital loss into an ordinary loss. These are certainly claims that Section 23 (g) (4) is applicable "with respect to" the year 1941, despite the specific terms of Section 101 of the 1942 Act. Congress used the words "applicable only with respect to taxable years beginning after December 31, 1941"—and not "in computing a tax liability", or making a tax return, for those taxable years—and the difference in meaning suffices to answer taxpayer's case.[12]

[12] In the Revenue Act of 1942, Congress did specifically provide, in some instances, that a Code amendment made by

Petitioner is not helped in escaping from the normal meaning of Congress' words by its argument that the statute employs the terms "applicable only with respect to" 1942 (instead of a phrase referring to tax liability or tax returns) as a means of making the amendments effective in *all* computations of tax liability for 1942, only in order to cover the changes made by the 1942 Act which did not concern computation of tax liability, such as the new provision removing the oath requirement in individual tax returns (Pet. Br. 34–5, 37). "With respect to" 1942 is entirely appropriate for making these non-computation amendments effective for 1942, without stretching the phrase into the equivalent of "*all* matters involved in computing a tax liability for" 1942. On the other hand, if, as petitioner urges, the legislative design had been to make the new amendments applicable to all matters concerned with 1942 tax liability, it would have been natural to use some term referring to tax liability for 1942, or to matters connected with tax liability for that year. (See *infra*, pp. 58–59, for a recent tax statute in which Congress did refer to "tax liability for" a given tax year.)

2. Our position is strengthened, not weakened, by the fact that the provisions of the 1924, 1926,

that Act should be applicable to the taxable year 1941. See *infra*, pp. 32–33. For other provisions of the 1942 Act which are expressly made retroactive, see 56 Stat. 836, 841, 881, 897. See also fn. 10, *supra*, p. 23, fn. 21, *infra*, p. 34, and *infra*, pp. 58–59, for comparable retroactive clauses of other acts.

1928, and 1932 Revenue Acts, which permitted the carry-over of net loss from an earlier year,[13] expressly provided that such net loss should be computed under the law in effect during the earlier period.[14] (Pet. Br. 21–2.) A net loss carry-over deduction had been allowed under the Revenue Acts in effect from 1918 through 1932,[15] and was thereafter discontinued, until it was restored in 1939 by amendments to the Code made by Section 211 of the Revenue Act of 1939, c. 247, 53 Stat. 862. In reviving the mechanism in 1939, Congress referred to the earlier carry-over provisions, and evidently sought to model the new sections generally on the prior practice, as taxpayer admits (Pet. Br. 31), without any suggestion of a departure from such a vital feature as the year governing computation of the net operat-

[13] Section 206 (e) and (f) of the Revenue Act of 1924, c. 234, 43 Stat. 253, Section 206 (e) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Section 117 (e) of the Revenue Act of 1928, c. 852, 45 Stat. 791; Section 117 (d) of the Revenue Act of 1932, c. 209, 47 Stat. 169.

[14] Under the 1924, 1926, 1928, and 1932 Acts, *supra*, the term "net loss" was used instead of "net operating loss."

[15] Section 204 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and of the Revenue Act of 1921, c. 136, 42 Stat. 227; Section 206 of the Revenue Acts of 1924 and 1926, *supra*; Section 117 of the Revenue Acts of 1928 and 1932, *supra*. The 1918 and 1921 Acts did not contain a special provision similar to that of the later statutes (see fn. 13, *supra*), because the net loss provisions of the earlier acts applied only to taxable years governed by those statutes, and the special provision was not needed. See *infra*, pp. 31–32.

ing loss. H. Rep. No. 855, 76th Cong., 1st Sess., pp. 6, 9).[16]

The difference of form between the Internal Revenue Code and the prior Revenue Acts, in making the law of the earlier year controlling in the computation of net operating loss for the earlier year, is readily explainable. Each of the Revenue Acts of 1924, 1926, 1928 and 1932 displaced the previous Act, was self-contained, and was effective only for the taxable year in which it was enacted and for whatever subsequent years intervened before the enactment of the next succeeding Act. The law of a prior year, therefore, could not control for any purpose under any of those Acts unless it was expressly so provided. This accounts for the fact that the allowance of a net loss deduction under the 1924, 1926, 1928, and 1932 Acts was accompanied by the express provision that the amount of the net loss in a prior taxable year, governed by another statute, should be determined in accordance with the law applicable to the year in which the net loss was sustained. (See also fn. 15, *supra*, p. 30.)[17] A comparable reference to a pre-Code statute is contained, for exactly the same reason, in section 26

[16] "This carry-over is substantially the same as that which was granted to them [i. e., individuals and partners] under the Revenue Act of 1928" (p. 6). See also *infra*, pp. 45–47.

[17] This provision covered only those net losses incurred in years governed by a prior act; no such provision was made where the loss was sustained in a year governed by the act itself, since it was unnecessary. See also fn. 15, *supra*, p. 30.

(c) (2) (B) of the Code (dealing with a different and minor net operating loss).

The Internal Revenue Code, on the other hand, has continuous application, and the Revenue Acts since 1939 have been additions or amendments to the Code. This structural difference between the Code and the Revenue Acts antedating the Code has resulted in the use of a general provision similar or identical to Section 101 of the 1942 Act,[18] under which all amendments are given prospective application, except as otherwise expressly provided. The old provisions remain fully in effect for prior years. Thus, the procedure for making the earlier year's law controlling in computing net operating loss for the earlier year is exactly the reverse of the procedure required with respect to the 1924, 1926, 1928, and 1932 Revenue Acts. Instead of an express provision making the law of the earlier year applicable to the earlier year, an express provision is required to make the amendment, or later law, applicable to the earlier year.

That Congress was quite well aware of this difference under the Code is illustrated by the amendments made by the 1942 Act to critical Section 122 ("Net operating loss deduction") itself. In amending subsections (b), (c), and (e), Congress expressly provided that the amendments should be applicable to the taxable year

[18] See Section 229 of the Revenue Act of 1939; Section 9 of the Revenue Act of 1940, c. 419, 54 Stat. 516; Section 118 of the Revenue Act of 1941, c. 412, 55 Stat. 687; Section 101 of the Revenue Act of 1943, c. 63, 58 Stat. 21; Section 2 of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231.

1941.[19] On the other hand, no such provision was made regarding the amendment to subsection (d) (4), which was therefore applicable only prospectively, under Section 101 of the 1942 Act.[20]

Similarly, no exception was provided for the new paragraph (4) of Section 23 (g) (deduction for capital losses), and the general provision governing the application of all amendments made by the 1942 Act—Section 101—likewise made this amendment prospective only. The former provision of Section 23 (g)—which barred taxpayer from claiming a net operating loss (*supra*, pp. 21–22)—continued to control "with respect to" 1941 matters.

Against this background of the distinction between the pre-Code Acts and the requirements

[19] Section 153 (a), (b), (c), and (e) of the 1942 Act, Appendix, *infra*, pp. 77–79; see *infra*, pp. 54–56.

[20] See Section 150 (e) of the 1942 Act (Appendix, *infra*, p. 77), which amended Section 122 (d) (4) of the Code. See fn. 22, *infra*, pp. 34–35.

Another amendment to Section 122 (d)—the addition of paragraph (6)—was made by Section 105 (e) (3) (C) of the 1942 Act (Appendix, *infra*, pp. 75–76), which, by references under Section 122 (b) (1) and (2) of the Code is amended by Section 153 (a) of the 1942 Act, may have been made applicable to the year 1941, for the purposes of Section 122 (b) of the Code. That amendment, a technical one, is of no importance here. It is discussed in fn. 37, *infra*, pp. 56–57.

The only other amendments made by the 1942 Act to Section 122 of the Code—aside from the above and those made by Section 153 (a), (b), (c), and (e) of the 1942 Act to which reference has just been made in fn. 19, *supra*—consisted of other technical amendments made to Section 122 (a), (c), and (d) of the Code by Section 105 (e) (A), (B), and (C) of the 1942 Act. These were applicable, under Section 101 of the 1942 Act, only with respect to 1942 and subsequent years. See Appendix, *infra*, pp. 70–74, 75–76; fn. 5, *supra*, p. 20.

of a continuing Code, the means employed for stating the effective date of the 1942 changes gives emphasis to our conclusion that those 1942 amendments which were made applicable only to 1942 and subsequent years are not to be used in computing net operating loss for 1941 and earlier years. For the general method adopted by Congress in revising the Code required that it should expressly provide if it intended its 1942 amendments to control as to a prior year, either for the purpose of computing tax liability or for the purpose of computing net operating loss for the prior year. In this very field of carry-overs, Congress did make such express provision when it desired the law of an earlier year to govern.[21] On the other hand, when an amendment is not expressly made retroactive, the amendment is no more to be applied in the computation of net operating loss for a prior year than it is to the computation of tax liability for that year.[22]

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[21] The Revenue Act of 1941 specifically provided, in connection with the analogous excess-profits credit carry-over (repealed by the Revenue Act of 1945 for taxable years beginning after December 31, 1946), that for the purpose of computing the unused excess-profits credit for a taxable year beginning in 1940 "the excess-profits credit and the excess-profits net income for any taxable year beginning in 1940 *shall be computed under the law applicable to taxable years beginning in 1941*" (italics supplied). Revenue Act of 1941, sec. 202 (e), 55 Stat. 701, 26 U. S. C. (1946 ed.), p. 2682.

[22] Our argument, of course, applies equally to the 1942 amendment to section 122 (d) (4)—the provision directly involved in *Moore, Inc.* v. *Commissioner*, 4 T. C. 404, affirmed 151 F. 2d 527 (C. A. 5)—and shows the error in that de-

D. The structure and purpose of the Code's net operating loss carry-over and carry-back provisions also require net operating loss to be computed under the law in effect during the year in which the loss is sustained

Section 122, the portion of the Code defining and regulating the net operating loss deduction and containing the carry-over and carry-back provisions,[23] clearly reflects the Congressional intent that, as under the earlier Revenue Acts permitting a net loss carry-over deduction, net operating loss for any given year is to be computed in accordance with the law applicable to that year, rather than to the year in which a carry-over or carry-back deduction is claimed.[24]

1. As we pointed out at the outset (*supra*, pp. 15–17), subsections (b) and (c) of Section 122 together make provision for determination of the amount of the *net operating loss deduction* for the particular taxable year, here 1942. That deduction, under subsection (c), consists of carry-overs and carry-backs of net operating loss of other years, which carry-overs and carry-backs are authorized by subsection (b). What may be used in any year as a carry-over or carry-

cision. At the same time, it destroys petitioner's bootstrap argument that section 23 (g) (4) must apply in determining 1941 net operating loss because amended section 122 (d) (4) controls the computation of 1941 net operating loss. See *supra*, pp. 14, 24–25, 27; *infra*, pp. 60–66.

[23] The role of Section 23 (g) (deduction for capital losses), with which we mainly dealt in Part C, *supra*, is that it partially defines the term "capital assets" in Section 122 (d) (4). See *supra*, pp. 22–24; fn. 22, p. 34; *infra*, p. 62–64.

[24] Section 122 is reprinted, in pertinent part, *infra*, pp. 70–74.

back depends upon the law in effect in the year in which the carry-forward or carry-back is effective, but the grant of the right to carry-over and carry-back and to take a net operating loss deduction in the taxable year can be availed of by a taxpayer only if he has a net operating loss for a proper prior or subsequent year. And Section 122 itself defines what should be the net operating loss for the prior or subsequent year—the starting point for every carry-over and carry-back—in terms which show that the law applicable to the year of deduction is irrelevant, and that the law governing the year of loss is decisive.

a. Provision for the computation of *net operating loss* for any year is made under the provisions of subsections (a) and (d), and those subsections alone. Subsection (a) defines the term "net operating loss" to mean—

> the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).[25]

Far from being "purely academic in the year 1941 when the excess of the deductions over the gross income actually occurred" (Pet. Br. 15), this subsection of Section 122 is the sole definition of net operating loss for *any* year, including 1941. Thus, the "net operating loss" for any particular

[25] See fn. 5, *supra*, p. 20 for an immaterial change in subsection (a) made by the 1942 Act, adding "additions" to "exceptions and limitations."

year (*e. g.*, 1941) consists of the gross income *for that year* minus the deductions "allowed by this chapter" (the income tax chapter) *for that year* (with the adjustments provided in subsection (d)). It is axiomatic that deductions are "allowed by this chapter" for a particular year only by virtue of the law applicable to that year. It is also axiomatic that the deductions "allowed by this chapter" for a particular year are the deductions allowed in the computation of tax liability for that year. Under Section 122 (a), therefore, the deductions from 1941 gross income allowed in computing net operating loss for 1941 are the very same deductions allowed in the computation of tax liability for 1941—with the adjustments provided in subsection (d). It follows that the base for computation of the net operating loss for 1941 must be the general income tax law in effect for that year, and there can be no justification for the distinction which taxpayer draws between the law applicable for the purpose of computing net operating loss for 1941 and the law applicable to 1941 generally—that is, the law applicable in the computation of tax liability for 1941. On taxpayer's view that 1942 law governs, the whole of its 1941 operations, and not merely that portion relating to the liquidation of Reo Sales, should be reaudited and its income recomputed under all the deduction and income provisions applicable to 1942 income tax returns, to see whether it suf-

fered a net operating loss in 1941.[26] But there would certainly be no warrant in the statute for this extraordinary recomputation, even though consistency to taxpayer's theory would require it. Section 122 (a) simply cannot be read as defining "net operating loss" *for 1941* as meaning the difference between the taxpayer's gross income for 1941 (calculated according to 1942 law) and "the deductions allowed by this [income tax] chapter", for 1942 incomes rather than for those of 1941.

The existence of the adjustments provided in subsection (d) does not change this result.[27] For these "exceptions and limitations" (or "exceptions, additions, and limitations," as the 1942 Act changed subsection (a) to read) are adjustments to be made in the difference between the gross income for a given year (*e. g.*, 1941) and the deductions allowed for that same year (*e. g.*, 1941)—*i. e.*, a net loss computation wholly determined by the law of that year, as we have just shown (*supra*, pp. 36–38)—and there is no reason to assert that the adjustments to be made in this loss are to be governed by the law of another year. For in-

[26] Petitioner has not suggested this overall recomputation.

[27] As pointed out in fn. 6, *supra*, p. 21, these adjustments may make the difference between a *net loss* for a tax year and the *net operating loss* subject to carry-over and carry-back (and deduction) in another year.

The adjustments provided in Section 122 (d) were for the purpose of insuring that only an economic, and not a theoretical, loss would be taken into account. H. Rep. No. 855, 76th Cong., 1st Sess. (1939–2 Cum. Bull. 504), p. 17.

stance, Section 122 (d) (4), involved here, constituted a *limitation,* for the purpose of computing 1941 net operating loss, upon the taxpayer's net loss for 1941, as determined by 1941 law, and *as such a limitation* upon that 1941 loss it would naturally be applicable in its 1941, and not its 1942, form—unless Congress made special provision to the contrary.

b. Petitioner's error is made clear by the tripartite division of the Code's net operating loss provisions, to which we have referred. *Supra,* pp. 16–17. The starting point is always (i) the "net operating loss" incurred in a given year; if such a loss exists, and only if it exists, under the statutes then in effect, the taxpayer may avail himself of (ii) the "carry-back" and "carry-over" device, and thereafter make use of the loss to offset income in another year by means of (iii) a "net operating loss deduction."[28] The first step, on the one hand, and the second and third, on the other, are normally controlled by the law of different years. Unless specific provision is otherwise made:—The "net operating loss" for a given year is governed by the statutes generally applicable to that year. The amount of a net operating loss which may be considered a "carry-over" or "carry-back,"

[28] "Net operating loss" is governed by section 122 (a); "net operating loss carry-back" and "net operating loss carry-over" are governed by section 122 (b) (1) and section 122 (b) (2), respectively; "net operating loss deduction" is governed by section 122 (c).

and the extent to which the "carry-over" or "carry-back" is used as an offset to net income in another year, are determined by the law of the later or earlier year in which the "carry" is to be effective.[29] Similarly, the law of the year in which the taxpayer seeks to take a "net operating loss deduction" controls whether and to what extent such a deduction is allowed in that year, and the amount of the carry-overs and carry-backs to be included.[30] In Reo Motors' case, 1941 law determines whether and to what extent a net operating loss was sustained by taxpayer in that year, but 1942 law indicates the extent to which such a

[29] For instance, subsection (b) of Section 122 now requires that net operating loss be offset against net income of the carry-back and carry-over years, computed with stated adjustments. The nature and extent of this offset is ruled by the law in effect at the time it is made and given effect (*i. e.*, Section 122 (b), as it stands at the particular time). And net income of the carry-back or carry-over year, against which net operating loss is to be offset, is to be determined in accordance with the law of the carry-back or carry-over year, unless contrary provision is specifically made. But the computation of the offsetting net operating loss is governed by the rules in effect in the earlier or later year in which it was sustained.

[30] For example, if a 1942 amendment to Section 122 had directed that only half of a net operating loss carried over from a prior year could be deducted in any one year, that 1942 amendment would control a taxpayer's net operating loss deduction for 1942 and only half of its 1941 loss could be offset against 1942 income. But the computation of the 1941 net operating loss itself would be governed by the legislation effective in 1941.

loss, if any, may be deducted in 1942 from petitioner's gross income for that year.[31]

2. a. The terms of Section 122, and its legislative history, likewise prove that the net operating loss for any given year will be a *fixed amount,* not subject to annual fluctuation. Subsection (b) (2), for example, states that "If for any taxable year the taxpayer has a net operating loss, *such* net operating loss" shall be a carry-over for the two succeeding years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, "of the amount of *such* net operating loss" over the net income for the intervening year computed with certain adjustments, and by determining the net operating loss deduction for such intervening taxable year without regard "to *such* net operating loss" and without regard to any net operating loss carry-back (italics supplied). Subsection (b) (1) con-

[31] In this connection, petitioner mistakenly describes the Government's "basic" position as "that the amount of the net operating loss is determined by reference to the law applicable to the year of loss, the net operating loss carry-over by reference to the law applicable to the intervening year and only the net operating loss deduction itself by the law applicable to the year of deduction." (Pet. Br. 29–30). Our position is stated in the text and the preceding footnotes. It may be noted, first, that ordinarily the year of a net operating loss deduction will coincide with the year of a carry-over or carry-back, or both, and, secondly, that Congress does sometimes make special provision for amendments to govern in other years. See *supra*, pp. 23 (fn. 10), 28 (fn. 12), 31–34 (esp. fn. 21); *infra*, pp. 56–57 (fn. 37), 58–59.

tains similar language regarding the carry-back to the first preceding year.

The statute's terms aside, it is also plain from the legislative history that Congress assumed that it was the actual and fixed amount of net operating loss for a given year—represented by an excess of allowable operating loss deductions for that year over gross operating income for that year—which was to be offset, until exhausted, against net operating income of other years for which carry-overs and carry-backs were authorized. This is clearly reflected in the various examples of the operation of the carry-over and carry-back provisions given in H. Rep. No. 855, 76th Cong., 1st Sess., pp. 9–10, 17–18 (on the 1939 net loss carry-over provision) and S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 122–123 (1942 revision of Section 122)—all of which use a fixed amount as the net operating loss for a given year. See *infra*, p. 46–47. See also, Treasury Regulations 111, Sec. 29.122–4.

This requirement that the net operating loss be a fixed amount can only be fulfilled if it be computed in accordance with the law applicable to the year in which the loss is sustained. Under taxpayer's construction, the amount (or the very existence) of the net operating loss may change radically, depending on which of the four years to which it is carried. *Supra*, pp. 15–16, 35–36, 39–41. The definition of "gross income", and the deductions allowed, as well as the adjustments

provided in Section 122 (d), may and in some instances do vary from year to year, and the computation of net operating loss for a given year would likewise necessarily change.

b. Moreover, under the statutory plan and the clear Congressional understanding (as its examples, cited above (p. 42), show), a net operating loss may not be carried to any taxable year so long as there is income in a prior year to which the loss could be applied. That is, a 1940 loss cannot be carried to 1942 so long as there is income in 1941 which could absorb the 1940 loss. Taxpayer's contention cannot be applied consistently with this legislative scheme in allowing the net operating loss deduction, as an example will make clear. Assume that X had a net operating loss of $50,000 for 1940, as computed under either 1940 or 1941 law, and net operating income [32] of $75,000 for 1941. The deduction in 1941 of the 1940 net operating loss would give X the full benefit Congress intended, and the full 1940 net operating loss carry-over would be exhausted. Assume further, however, that under *1942* law X's 1940 net operating loss was $100,000, instead of $50,000, by reason of the fact that pertinent deductions were allowed in 1942 which were not allowed in 1940 or 1941. X would, under tax-

[32] The term "net operating income" is used to designate net income as computed with the exceptions and limitations of Section 122 (d), which adjustments are applicable in the computation of net income subject to offset by net operating loss under Section 122 (b).

payer's contention, now have a net operating loss carry-over from 1940 to 1942, of $100,000 minus $50,000 (the carry-over deducted in 1941), or $50,000, despite the fact that X's actual 1940 net operating loss had already been deducted in full by offset against 1941 income. The net operating loss for the year 1940 is obviously not a fixed amount from year to year, on this theory, nor is the 1941 net operating income wholly offset by the 1940 loss before that loss is carried over to 1942. There would still be unabsorbed $25,000 of net operating income for 1941, and yet X would have a carry-over of $50,000 to 1942. This cannot be the proper construction of Section 122.[33]

c. Again, petitioner's construction of the statute would result, in some cases, in retroactively allowing a net operating loss carry-over from a year in which the taxpayer had net income under the law controlling that year, and for which it had to pay a tax, and therefore had no actual loss at all. The Fifth Circuit, in its *Moore* opinion, thought that Congress intended to "produce"—via amendments of the type involved here—"a net loss which had not in truth existed" (151 F. 2d, at 529). But as early as the net loss provisions of the Revenue Act of 1924,

[33] The administrative complexities and difficulties of the recomputations and reaudits which petitioner's construction would entail likewise urge strongly against its view. Cf. *Crane* v. *Commissioner*, 331 U. S. 1, 10, affirming 153 F. 2d 504, 505 (C. A. 2).

the House Committee on Ways and Means expressly indicated that it considered such a result to be "anomalous" and to be avoided in the working of the net loss mechanism. Report of the House Committee on Ways and Means on the Revenue Bill of 1924, H. Rep. No. 179, 68th Cong., 1st Sess., p. 19 (1939–1 (part 2) Cum. Bull. 241, 254–5). There is no reason to suppose that the Congresses which molded the Code net operating loss provisions on the pattern of the earlier acts took a different view.

3. Perhaps above all, taxpayer's argument should be rejected because it radically departs from the prime purpose of Congress to secure approximate tax equality (a) between businesses with stable profits and those with fluctuating earnings, and (b) among taxpayers suffering losses in some years and earning profits in others. *Supra,* pp. 17–18.

As the committee reports reveal, the major point of the net operating loss provisions is to do away with the larger amount of taxes imposed on taxpayers with alternating losses and profits, as compared with the taxes paid by businesses with less fluctuation in earnings. Though their average earnings over a span of years might be the same, before 1939 the latter class of taxpayers could take advantage, and receive the benefit of, their deductions in each taxable year, thus decreasing the amount of taxes paid over the

years, while the former only realized a tax benefit from their deductions in profitable years; in years of loss, a portion of their deductions went to waste, so to speak, and could not be used to reduce their already nonexistent tax. Congress' purpose in adopting and amending the net operating loss device was to remedy this defect by allowing a business with fluctuating profit-and-loss to receive the benefit of its deductions. See *supra*, p. 17–18.[34]

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[34] H. Rep. No. 855, 76th Cong., 1st Sess. (1939–2 Cum. Bull. 504) stated, in recommending the readoption of a net operating loss carry-over in 1939 (pp. 9–10):

"2. *Net loss carry-over.*—The bill, together with the committee amendments, permits taxpayers to carry over net operating business losses for a period of 2 years. Prior to the Revenue Act of 1932, such 2-year carry-over was allowed. No net loss has ever been allowed for a greater period than 2 years. In the Revenue Act of 1932, the 2-year net loss carry-over was reduced to 1 year and in the National Industrial Recovery Act the net loss carry-over was entirely eliminated. As a result of the elimination of this carry-over, a business with alternating profit and loss is required to pay higher taxes over a period of years than a business with stable profits, although the average income of the two firms is equal. New enterprises and the capital-goods industries are especially subject to wide fluctuations in earnings. It is, therefore, believed that the allowance of a net operating business loss carry-over will greatly aid business and stimulate new enterprises. * * * An example will show the necessity for such a provision.

"Suppose a corporation, over the 3-year period 1939–41, shows the following:

Net operating loss for 1939	$2,000,000
Normal-tax net income for 1940	1,000,000
Normal-tax net income for 1941	1,000,000

"Looking at this 3-year period, it will be seen that the corporation has not made any profit. However, assuming a

If, however, a taxpayer may recompute its net operating losses for prior or subsequent years, in the course of carrying-over or carrying-back the net operating loss for deduction in another tax year, this result is not achieved. Some tax-

flat rate of 18 percent, it would be required to pay a tax of $360,000 if there were no provision for a net loss carry-over. Under the bill, a corporation in such a case would not be required to pay an income tax."

In advising the adoption of the carry-back provisions, in 1942, S. Rep. No. 1631, 77th Cong., 2d Sess. (1942-2 Cum. Bull. 504, 546-7), pp. 51-2 stated:

"The present law permits corporations to carry forward for 2 years their net operating losses. It also allows the unused excess-profits credit to be carried forward for 2 years. These provisions obviously are of benefit only in periods of increasing business activities. Many corporations will suffer substantially in periods of declining profits, especially at the close of a war economy in which their deductible expenses have been held down to a bare minimum by priorities, rationing, labor shortages, and other factors beyond the control of the taxpayer. For example, a corporation during the war years makes substantial profits which would be considerably reduced if it could make the expenditures possible in a free economy for maintenance, repair, and other deductible expenses. Upon the termination of the war, the materials and labor will once more be available, but the costs and expenses which would otherwise be taken against the wartime profits will fall into the years of lesser profits or of no profits, thereby resulting in small or no tax benefit for the taxpayer.

* * * * *

"To afford relief to these hardship cases, where maintenance and upkeep expenses, must, because of wartime restrictions be deferred to peacetime years, your committee has provided a 2-year carry-back of operating losses and of unused excess-profits credit. This provision affords, in effect, the same type of relief in periods of declining profits which the present 2-year carry-forward of operating losses and unused excess-profits credits affords in periods of increasing profits."

payers will secure extra deductions, unavailable to those who have no losses and who therefore cannot use the carrying mechanism; others will lose deductions which are available to taxpayers with steadier earnings.

a. For instance, beginning with taxable year 1942, but not before, Congress has allowed a statutory deduction for amortizable bond premiums (Revenue Act of 1942, Secs. 101, 126, 56 Stat. 798, 802, 822). Assume that Corporation A in 1941 has $10,000 of gross income and $10,000 of allowable deductions under 1941 law—a net income of zero, and no tax—and also $1,000 of amortizable bond premium attributable to 1941. Corporation B has greater profits in 1941; it has $12,000 of gross income and $10,000 of allowable deductions—a net income of $2,000, on which a tax is paid—and likewise $1,000 of amortizable bond premium attributable to 1941 (assuming that this $1,000 is not deductible in another connection).

When 1941 is recomputed under 1942 law, on petitioner's theory, Corporation A will have $11,000 of allowable deductions, and therefore a new operating loss of $1,000, which can be carried over from 1941 and deducted in 1942. However, if Corporation B's 1941 income and deductions are recomputed under 1942 law, its extra $1,000 of deductions will not be enough to give it an excess of deductions ($11,000) over gross income ($12,000), and there would be no operating loss

to carry over to 1942. The $1,000 deduction for amortizable bond premium could, therefore, never be deducted by Corporation B, but would, on the other hand, be deducted by Corporation A in its 1942 return. In this way, Corporation A would be given the benefit of an extra deduction for 1941 which other taxpayers operating without loss could never receive. It would not only be permitted to pay tax on its average income over a period of years but would receive an additional benefit which there is no indication Congress intended to confer.[35]

b. Still another example will serve to illustrate that a taxpayer which *actually* had a net operating loss in a given year might be deprived of a deduction therefor by computation of net operating loss in accordance with taxpayer's contention. Assume that Y had net operating income of $50,000 for 1941 and a net operating loss of $50,000 for 1943, as computed under the law applicable to 1943. Under Section 122 (b), the 1943 net operating loss must first be carried back to the second preceding year, here 1941, before it may be applied to the other carry-back and carry-over years. *Supra*, pp. 15–16. When the $50,000 net operating loss actually sustained by Y in 1943 (as computed under 1943 law) is offset against 1941 net operating income of $50,000, as we contend it should be, Y will have received the

[35] Another example of this type of discrimination is given above, at pp. 43–44.

benefit Congress intended in making provision for the net operating loss deduction. However, under taxpayer's argument the law applicable to 1941 would have to be applied in computing Y's 1943 net operating loss. Let us say that the 1941 law did not allow certain deductions allowed in 1943, and that Y's net operating loss for 1943 is not $50,000 but $25,000, as computed under the law applicable to 1941. Y could take a carry-back deduction in 1941 of only $25,000 (instead of $50,000) for 1943 net operating loss, and therefore would have to pay tax on the remaining $25,000 of income in 1941. Y would thereby be deprived of a deduction in 1941 for a net operating loss of $25,000 which it actually sustained in 1943, and thus would not have the right to average out its 1943 loss against 1941 income, as Congress intended.[36]

Nor would Y be able to deduct the remaining $25,000 in the second carry-back year, 1942—in which its net income was $25,000—even assuming that its 1943 loss (as computed under 1942 law) was $50,000. Under Section 122 (b) (1), the carry-back to, and deduction for, 1942 is limited

[36] If the tables were turned in the present case, and a taxpayer which sustained a net operating loss in 1943 through the worthless stock of a subsidiary (other things being equal) were to carry that loss back to 1941, petitioner's theory would forbid it from deducting the loss in 1941, because the law of that year excluded such a loss from the computation of net operating loss. It would in effect lose the deduction granted it by Section 23 (g) (4).

to the excess, if any, of the amount of the net operating loss for 1943 over the net income for 1941 with certain adjustments. *Supra*, pp. 43–44. There would be no excess to be deducted in 1942, in the assumed example, since the 1943 loss (computed under 1942 law) is the same amount ($50,000) as the 1941 net income ($50,000). Similarly, Y would not be permitted to carry over the unused $25,000 of the 1943 loss to the years 1944 and 1945 as a deduction, assuming that the 1943 net operating loss (as computed under 1944 and 1945 law) remained $50,000. This is so because Section 122 (b) (2) requires the net operating loss for 1943 to be reduced by the sum of the net income for 1941 and 1942, with certain adjustments. (Appendix, *infra*, p. 71.) The sum of the net income for 1941 ($50,000) and 1942 ($25,000) is $75,000, which exceeds the 1943 loss of $50,000 and thus eliminates any net operating loss carry-over. It follows that Y would be prevented, under taxpayer's contention, from using his 1943 net operating loss as a complete offset to income of the carry-back and carry-over years, and the Congressional purpose to tax Y on the average of his income over the five-year period would be frustrated. (See also *supra*, pp. 43–44.)

4. On the other hand, the legislative intent is fully effectuated, and the terms of Section 122 are fulfilled, when net operating loss for any given year is computed according to the law ap-

plicable to that year. Such a computation of net operating loss results in a fixed amount of net operating loss for the given year, which, under Section 122 (b), may successively be applied as an offset against net income of the second preceding year, the first preceding year, the first succeeding year, and the second succeeding year. Only the remaining excess of that fixed amount over net income of each of those years is available as an offset against income of the next year, and the full amount of the net operating loss will presumably be offset against net income in one or more of the carry-back and carry-over years. Thus, a taxpayer who has an excess of deductions in one year over gross income of that year—*i. e.*, a net operating loss—is permitted to receive a tax benefit from those deductions in other years by an offset against net income of the other years. The result is payment of tax on the average of income over the years, as Congress intended—a result which, as we have shown, cannot be obtained by changing the amount of net operating loss for a given year from year to year according to the law applicable in those other years.

Petitioner's opposing contentions are all far wide of their mark. *First:*—It seems to urge (Pet. Br. 13–14) that since this case happens to involve a deduction disallowed under 1941 law in computing net operating loss for 1941, but

allowed in computing net income and tax liability for 1941 (see fn. 6, *supra*, p. 21), the Court should entirely disregard the Congressional purpose we have outlined and the structure of the net operating loss provisions (*supra*, pp. 35–52). It is true that this particular taxpayer will not "gain an extra deduction" in the same sense as the taxpayers in some of our examples (*supra*, pp. 43–44, 48–49)—because Congress did permit its stock loss to be deducted in determining 1941 net income—but it will be enabled to bypass a specific limitation which Congress imposed, for reasons which seemed good to it, on the computation of 1941 net operating loss, while other taxpayers will be subject to the exceptions and limitations Congress specified in subsection (d) of Section 122.[36a]

Moreover, petitioner's argument seems to be that because the worst consequences of its proffered interpretation will not occur in this particular instance, its general theory may be accepted without hesitancy. But, as we have shown (*supra*, pp. 29–52), the terms and structure of Section 122, as well as its purpose, history, and aim, require the general conclusion that computation of net operating loss be controlled by the law of the year in which the loss is sustained, and there is no room in the statute's

[36a] It is to be noted that tax rates were higher in 1942 than in 1941, and petitioner would probably secure a decided advantage if it could take a large deduction, resulting from its stock loss, in the latter year.

language for a special exception covering petitioner's particular case. Conversely, taxpayer's theory cannot be adopted, or its contention upheld in this case, without at the same time opening the door, under the statute's terms, to all the incongruous consequences we have sketched, and to the nullification of Congress' policy of achieving approximate tax equality.

Second.—There is no merit in the argument taxpayer makes (Pet. Br. 26–30) in reliance upon some language in S. Rep. No. 1631, 77th Cong., 2d Sess., *supra,* p. 47. The amendments made by Section 153 of the Revenue Act of 1942 (Appendix, *infra,* pp. 77–79) were to Section 122 (b) (c) and (e) of the Code and for the most part added provisions permitting net operating loss carry-backs for the first time. Section 153 also amended Section 122 (e) of the Code to provide that there was to be no carry-back to years prior to 1941, and these amendments made by Section 153 were expressly made applicable to taxable years beginning after December 31, *1940.*[36b] *Supra,* pp. 32–33. In this connection, S. Rep. No. 1631, *supra,* p. 123, stated that the carry-overs from the years 1939 and 1940 to the taxable year 1941, and the carry-backs to 1941 from the years 1942 and 1943, would be determined under the amendments made by Section 155, which later became Section 153. That statement, upon which taxpayer relies (Pet. Br. 27), had reference, mainly if not entirely, to the fact that it was permissible under

[36b] Subsection (a), defining net operating loss, was not affected by these amendments.

Section 122 (b) of the Code, as newly amended, not only to carry-over but to carry-*back* net operating losses to 1941, and the carry-back device was specifically made retroactive to cover the taxable year 1941. See R. 221–2.

Petitioner, however, reaches the conclusion, by a complex process of deduction (Pet. Br. 27–29), that the Committee must have meant that net operating losses for 1939 and 1940 were to be computed under the law as amended in 1942, if a net operating loss deduction were taken in 1941 or 1942. But the fact is that computation of net operating loss was in no way involved, because net operating loss is governed by subsections (a) and (d) of Section 122 (*supra,* pp. 36–39), and not by subsections (b) and (c) (the carry-over and carry-back provisions) which alone were involved in the amendments made by Section 153 (of the 1942 Act) to which the Committee was referring. As we have pointed out (*supra,* pp. 15–17, 35–41), there is a sharp distinction between the computation of net operating loss for a given year and the determination of whether and to what extent that loss is to be carried forward or backward. If the Committee's words have any bearing on this matter at all, it plainly was dealing solely with the latter aspect. It was asserting that the portion of the net operating losses for 1939 and 1940 which were to be carried over *to 1941,* and deducted in that year, would be governed by the carry-over and carry-back amendments expressly

made applicable, by the 1942 Act, to 1941. It gave no intimation that computation of a 1939 or a 1940 net operating loss itself was to be governed retroactively by the 1942 amendments.[37] (By way of contrast, see fn. 21, *supra*, p. 34, for an instance in which Congress did specifically direct, in comparable carry-over circumstances, that the law of a later year govern.)

Third:—The attempt is also made to argue, by way of misplaced analogies to different statutes and different tax situations, that Congress must have intended net operating loss for 1941, which is carried over and deducted in 1942, to be com-

[37] As to petitioner's involved and inferential argument based on Section 122 (d) (6) of the Code (Pet. 28–30), it should be said that that provision was added by Section 105 (e) (3) (C) of the 1942 Act as one of the "Technical Amendments Made Necessary by Change in Base for Corporate Tax" (Appendix, *infra*, pp. 75–76; see fn. 20, *supra*, p. 33) and relates to a deduction for payment of excess profits tax which is not involved here. The amendment is governed by Section 101 of the 1942 Act, and is therefore ordinarily effective only as to tax years beginning in 1942, or thereafter. It was added to provide for the deduction, beginning in 1942, of the excess profits tax paid or accrued within the taxable year for purposes of computing the net operating loss and the carry-overs and carry-backs for that year, because the excess profits tax was not allowed as a deduction in computing net income for taxable years beginning in 1942, or thereafter. 56 Stat. 806. The amendment would, therefore, not seem to have any bearing on computation of net operating loss, or offsetting net income, for years prior to 1942 (since the excess profits tax was deductible under 1941 law in computing 1941 tax liability).

Assuming, however, with petitioner (though the assumption is very doubtful in light of the facts just stated) that

puted according to the "year of tax liability" (*i. e.,* 1942), or else it would have "clearly provided" otherwise. (Pet. Br. 20–26). The argument thus far has shown, we believe, that both (a) the specific terms of Section 101 of the 1942 Act, indicating the taxable years to which the 1942 amendment here involved is applicable (*supra,* pp. 26–34), and also (b) the terms, structure, purpose, and legislative history of the Internal Revenue Code's net operating loss provisions (*supra,* pp. 29–52), require the taxpayer's 1941 net operating loss to be determined under 1941 law. Thus, Congress *has* "clearly provided" to the contrary of petitioner's contentions, and this firmly-supported conclusion, based on explicit

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the references in the amended Section 122 (b) (effective in 1941), and the cryptic statement of the Senate Committee (particularly its ambiguous reference to certain adjustments "now" required), indicate that subsection (d) (6) is somehow to be used in computing the portion of the 1940 net income to be offset in determining a carry-over of 1939 net operating loss to 1941, we fail to see the relevance of the argument to the present case. If this is so, it is because the new Sections 122 (b) and (c) expressly control net operating loss carry-overs to, and net operating loss deductions in, 1941, and in that connection determine the extent to which a prior net operating loss, which is to be carried to 1941, may be offset in 1940. We may repeat that this is no indication whatever that computation of the net operating loss itself is also to be computed under the law applicable to year of deduction. Furthermore, if partial retroactive effect is given to the 1942 addition of Section 122 (d) (6) in the computation of 1941 net operating loss, or otherwise, it is solely because Congress made special provision to that effect, in Section 153 (a) of the 1942 Act (*supra,* p. 33), and no general rule can be deduced from this specific statutory exception.

and affirmative indications of legislative meaning, can hardly be destroyed by reference to the following remote and plainly distinguishable situations and cases:—

As the court below held (R. 222), taxpayer can derive no aid from Treasury Regulations involving profit from installment sales (Pet. Br. 23–5), since installment payments are properly governed, under the statutes and regulations, by the law of the year in which received, when they become taxable, and not according to the year in which the sale was made. *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 502–3, 505–6; *Snell* v. *Commissioner*, 97 F. 2d 891, 893 (C. A. 5). Likewise, *Community Public Service Co.* v. *Commissioner*, 12 T. C. 893 (May 31, 1949), does not support petitioner. There, the taxpayer was permitted to compute its unused excess profits tax credit for 1941 and 1942, carried over to 1943, on the basis of a 1943 amendment, solely because a provision having the effect of the 1943 amendment was expressly required by Congress to "be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1933" (58 Stat. 43), and the Tax Court held that recomputation of the 1941 and 1942 unused excess profits tax credit was thus expressly sanctioned.[38] In making the amendment retroactive,

[38] The particular 1943 amendment, which was retroactively made applicable to all years after 1933, concerned the use by the taxpayer of its predecessor's basis for assets acquired from the predecessor under a plan of reorganization.

Congress added that it was, however, not to "affect any *tax liability* for any taxable year beginning prior to January 1, 1943" (53 Stat. 43; italics supplied); the Tax Court held that this provision was no bar because only tax liability for 1943, and not for 1941 or 1942, was involved (12 T. C. at 897). If anything, this latter portion of the *Community Public Service* case works directly against petitioner. For in the present instance the section of the 1942 Act bearing on the effective date of the disputed amendment makes it "applicable only with respect to taxable years" 1942 (and thereafter), and says not a word about "tax liability" (*supra*, p. 26). Yet petitioner's whole argument admittedly is an effort to prove that Congress nevertheless intended to say that the amendment was to be applicable in *all* matters involved "in computing a tax liability for" 1942 (see Pet. Br. 31–34). But it is evident that Congress knew how to use that phrase when it desired to do so. See also fn. 21, *supra*, p. 34 (unused excess profits credit carry-over).

In *Forstmann* v. *Rogers*, 128 F. 2d 126, 128–129 (C. A. 3), the court reluctantly felt compelled, because of an apparently inadvertent but clear legislative omission, to hold tax-free in 1929 (when the bonds acquired in a 1922 exchange matured) any capital gains realized upon the exchange of those securities for other bonds in 1922, and which were not taxed at that time. The de-

cision clearly rested on the particular and unique statutory provisions there involved, and the Third Circuit was certainly not attempting to lay down any such general rule as petitioner seeks to formulate (Pet. Br. 25). Similarly, in *Dockendorff* v. *United States,* 84 F. Supp. 372, the Court of Claims held, on the basis of a detailed analysis of the particular partnership tax statutes and their legislative history, that Congress had spelled out, in the situation then before the court, a "special rule" which is "an exception to the general rule of Section 101" of the Revenue Act of 1942 (*supra,* p. 26; *infra,* p. 74) (84 F. Supp. at 378, 379). Again, no general principle, like that advocated by the taxpayer here, was promulgated, and the court was careful to confine its decision to the special tax situation with which it was dealing.[39]

Fourth:—Taxpayer's fundamental but circular contention, constantly reechoing throughout its argument, is that the 1942 amendment adding paragraph (4) to Section 23 (g) of the Code (*infra,* pp. 68–69 (fn. 1)) must apply in this case because the 1942 amendment to Section 122 (d) (4) (*infra,* p. 73, fn. 5) governs all net operating loss and all net operating loss deduction computations in 1942 (Pet. Br. 11–19; 32–33, 35–37). On that assumption, the claim is that the refer-

[39] At pp. 29–34, *supra,* we discuss petitioner's further contention that the difference between the wording of the net loss provisions of the 1924, 1926, 1928, and 1932 Revenue Acts, and the net operating loss provisions of the Internal Revenue Code indicates a change in governing law (Pet. Br. 21–2).

ence in the amended Section 122 (d) (4) to "capital assets", must have the same meaning as the same term bears in Section 23 (g)—as simultaneously amended in 1942 by the addition of paragraph (4)—and, therefore, taxpayer's Reo Sales stock cannot be deemed a "capital asset," in 1942, for the purposes of Section 122 (d) (4).

The fallacy is twofold. In the first place, petitioner's argument wholly depends on the application of the amended Section 122 (d) (4) to this case, and therefore assumes its conclusion. For under Section 101 of the 1942 Act, the amendment to Section 122 (d) (4)—like the amendment to Section 23 (g)—is "applicable only with respect to taxable years beginning after December 31, 1941," and is therefore not applicable in the computation of net operating loss for 1941, for precisely the same reasons as Section 23 (g) (4) is inapplicable. See *supra*, pp. 24–25, 26–52. (The contrary conclusion in *Commissioner* v. *Moore, Inc.*, 151 F. 2d 527 (C. A. 5), affirming 4 T. C. 404, we believe to be erroneous, as we stated at the outset of our argument (*supra*, pp. 14, 24–25)).[40] The earlier version of

[40] It should be added that the holding in the *Moore* case was also contrary to the provisions of Section 19.122–2 of Treasury Regulations 103, as amended by T. D. 5217, 1943 Cum. Bull. 314, 329, and of Section 29.122–2 of Treasury Regulations 111, which are identical. Under the Regulations the amendment to Section 122 (d) (4) was made applicable only in the computation of net operating loss for 1942 and subse-

Section 122 (d) (4) is thus the only one applicable here (*supra*, pp. 20–21; *infra*, p. 73), and since petitioner's argument rests on the opposite, but erroneous, assumption that the 1942 amendment to Section 122 (d) (4) controls in computing 1941 net operating loss, it is necessarily infected with a fundamental error.[41]

In the second place, the terms "gains and losses from sales or exchange of capital assets" in Section 122 (d) (4) are "neutral" terms,

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quent years. Section 29.122–2 of Treasury Regulations 111 provided:

"SEC. 29.122–2. *Computation of Net Operating Loss in Case of Corporation.*—A net operating loss is sustained by a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions, additions, and limitations:

* * * * *

"(4) For any taxable year beginning after December 31, 1938, and before January 1, 1942, the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of short-term capital gains. For any taxable year beginning after December 31, 1941, the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of such assets; * * *"

[41] Petitioner appears to agree with us that the *Moore* case cannot be distinguished from the present one (Pet. Br. 19, 33), and there is therefore no way of commencing an argument from the postulate that *Moore's* holding as to Section 122 (d) (4) is correct, and thus escaping the vicious circle. Both cases stand on the same footing. See, *supra*, pp. 14, 24–25, 27, 60–62; *infra*, pp. 64–66.

normally taking their definitions from other Code sections, applicable to a given year, and do not embody in themselves a particular fixed definition of "capital assets." Here, that phrase takes its meaning from Section 23 (g); taxpayer urges that the 1942 version of Section 23 (g) supplies the definition, while the Government contends that the 1941 form governs. If, for instance, Congress should repeal Section 23 (g) (4) in 1950, and reinstate the 1941 law on the subject of losses on stock in an affiliated corporation (making them capital losses again), it would not be necessary to refer to, or amend, Section 122 (d) (4). For the tax years governed by the hypothetical 1950 change, "capital assets" in Section 122 (d) (4) would automatically take on the new meaning. It is true, as petitioner states (Pet. Br. 17–18), that Congress does define such terms as "gains and losses from sales or exchange of capital assets" (Pet. 17–18), and the definition must be followed, but the difficulty with petitioner's argument is that the very same terms are sometimes redefined and can easily have different meanings in different years.[42] "Capital assets" in section 122 (d) (4) includes stock in an affiliated corporation, such as petitioner's Reo Sales stock, for 1941 purposes, and

[42] For example, real property used in trade or business was a "capital asset" before 1942, but in 1942 was excluded from the definition of that term. 56 Stat. 846.

excludes such stock in 1942, because Congress altered the governing definition.[43]

As for the *Moore* case (151 F. 2d. 527, affirming 4 T. C. 404), which taxpayer uses for its main support, we believe that its reasoning, both in the Tax Court and in the Fifth Circuit, is diametrically opposed to that of the Tax Court and the Sixth Circuit in the instant case. This was recognized by Judge Leech, the single Tax Court judge who sat in the *Moore* case, in his sole dissent here; he thought that the "*ratio decidendi* in *Moore, Inc.* * * * applies with equal force here and requires the opposite conclusion to that of the majority" (R. 200).[44] The court below, noting that it was not bound by the Fifth Circuit's conclusion, found it unnecessary to determine whether the same or a different issue was presented and decided in the *Moore* case, because it held that the Tax Court's present result was correct in either event (R. 220). And there is added to this implicit recognition of indistinguishability, the fact that the rationale of the opinion below cannot be squared with that

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[43] We point out in fn. 7, *supra*, p. 21, the irrelevance to this case—even if the 1942 amendment to Section 122 (d) (4) applies—of the elimination, by that amendment, of the matching of long-term capital losses against long-term capital gains, and short-term losses against short-term gains, since petitioner had no capital gains of either kind.

[44] As stated in fn. 1, *supra*, p. 14, the present case, unlike *Moore*, was reviewed by the full Tax Court bench of sixteen judges, and only Judge Leech dissented.

expressed by the Fifth Circuit. *Supra*, pp. 24–25, 26–34; cf. 35 *et seq.*

However, the Tax Court, in this and other cases, has attempted to distinguish the *Moore* case upon a ground not foreshadowed in that opinion. The difference, the court says, is that the earlier case involved a 1942 amendment directly altering a provision of Section 122 (d) (4) of the Code, while the instant case involves a 1942 amendment which did not change the provisions of Section 122 itself, but rather altered another Code provision (Section 23 (g)) partially defining certain terms ("capital losses" and "capital assets") used in Section 122 (d) (4) (R. 199–200).

In the Tax Court, and the court below, respondent has urged that this deduction is not valid, and that the present case and the *Moore* decision cannot properly stand together (R. 220). We reiterate that concession here. It does not seem to us to make any difference whether the later amendment changes one portion of the Code or another, as long as Congress does not indicate that the amendment is to have retroactive effect. Both the amendment involved in the *Moore* case and that with which we are now mainly concerned related to the computation of net operating loss under Section 122 (a), and both were specifically made applicable only to tax year 1942 and following. *Supra*, pp. 24–25. Both amendments should be treated alike, and, in our view, the

court below was correct in holding that, absent an express legislative direction to the contrary, computation of a net operating loss for 1941 must be determined by 1941 law, and the Fifth Circuit was wrong in its earlier holding to the contrary.[45]

CONCLUSION

The necessary conclusion is that, in restoring the net operating loss deduction in 1939 under Sections 23 (s) and 122 of the Code, the legislative purpose and general intent were the same as reflected by the earlier Revenue Acts allowing a net loss deduction. The earlier Revenue Acts required that net loss be computed in accordance with the law applicable to the year for which a net loss is claimed, rather than according to the law governing the year for which a deduction therefor is sought. As we have shown, the purpose of the Code's net operating loss provisions also requires such a computation of net operating loss. The structure and aim of Section 122 have the same effect as a specific provision requiring the computation of net operating loss for a given year according to the law applicable to that year. No exception was made in the case of Section 23 (g) (4), which is directly involved here. Indeed, that section was expressly not made applicable "with respect to" 1941. We believe the conclusion is inescapable that taxpayer is not entitled to apply Section 23 (g) (4) in comput-

[45] On the *Moore* case, see also *supra*, pp. 14, 24–25, 27, 60–64.

ing net operating loss for 1941, and therefore is not entitled to the net operating loss deduction it claims.

The decision below is therefore correct and should be affirmed.

Respectfully submitted.

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NOVEMBER 1949.

APPENDIX

I

Internal Revenue Code (26 U. S. C.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) *Securities becoming worthless.*—If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) *Definition of securities.*—As used in this subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.[1]

* * * * *

[1]An additional paragraph (4) was added to this subsection by Section 123 (a) (1) of the Revenue Act of 1942 (*infra*, p. 76) and amended by Section 112 (a) of the Revenue Act of 1943 (*infra*, p. 79). The paragraph as so added and amended is effective only with respect to taxable years beginning after December 31, 1941 (see Section 101 of the 1942 Act, *infra*, p. 74, and Section 112 (c) of the 1943 Act, *infra*, p. 79), and reads as follows:

"(4) *Stock in affiliated corporation.*—For the purposes of paragraph (2) stock in a corporation affiliated with the tax-

(s) [as added by Section 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) [as amended by Section 212 (a) of the Revenue Act of 1939, *supra*] *Limitation on Capital Losses.*—Long-term capital losses shall be allowed, but short-term capital losses shall be allowed only to the extent of short-term capital gains.[2]

* * * * *

(26 U. S. C. 1946 ed., Sec. 117.)

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payer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

"(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the company in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), an' ities, or gains from sales or exchanges of stocks and securities; and

"(C) the taxpayer is a domestic corporation."

[2] This subsection was amended by Section 150 (c) of the Revenue Act of 1942, effective under Section 101 of the 1942

SEC. 122 [added by Section 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*— As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).[3]

(b) [as amended by Section 153 (a) of the Revenue Act of 1942] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by deter-

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Act (*infra*, p. 74), only with respect to taxable years beginning after December 31, 1941, to read as follows:

"(d) *Limitation on Capital Losses.*—

"(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

"(2) *Other taxpayers.*— * * *"

[3] By section 105 (e) (3) (A), of the Revenue Act of 1942, (*infra*, p. 75), paragraph (a) of section 122 was amended by changing the last phrase to read: "with the exceptions, additions, and limitation provided in subsection (d)." Under Section 101 of the 1942 Act (*infra*, p. 74) this change was effective only with respect to taxable years beginning after December 31, 1941.

mining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) [as amended by Section 153 (b) and Section 105 (e) (3) (B) of the Revenue Act of 1942] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount,

if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in Section 26 (e));

(d) *Exceptions and Limitations.*—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows:[4]

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest or indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3 No net operating loss deduction shall be allowed;

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[4] By section 105 (e) (3) of the Revenue Act of 1942 (*infra*, p. 75), paragraph (d) of section 122 was amended to read as follows:

"(d) *Exceptions, additions, and limitations.*

"The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:"

Under Section 101 of the 1942 Act (*infra*, p. 74), this change was effective only with respect to taxable years beginning after December 31, 1941.

(4) Long-term capital gains and long-term capital losses shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of the long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of the short-term capital gains;[5]

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations

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[5] This paragraph was amended by Section 150 (e) of the Revenue Act of 1942 (*infra*, p. 77) effective under Section 101 of the same Act, (*infra*, p. 74) only with respect to taxable years beginning after December 31, 1941, to read as follows:

"(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains."

[6] Paragraph (6) was added by Section 105 (e) (3) (C) of the 1942 Act, (*infra*, pp. 75–76), and reads as follows:

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

specified in paragraphs (1) to (4) of this subsection.

(6) * * *

(e) [as amended by Section 153 (c) of the Revenue Act of 1942] *No Carry-Back to Year Prior to 1941.*—As used in this section, the term "preceding taxable year" and the term "preceding taxable years" do not include any taxable year beginning prior to January 1, 1941.[7]

(26 U. S. C. 1946 ed., Sec. 122.)

II

1. Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 101. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

Except as otherwise expressly provided, the amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1941.

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."

The paragraph is applicable under Section 101 of the Revenue Act of 1942, *infra*, only with respect to taxable years beginning after December 31, 1941, except to the extent the paragraph may come into play under Section 122 (b) (1) and (2) of the Code, *supra*, pp. 70–71, which is applicable to the year 1941. See fn. 20, 37, *supra*, pp. 33, 56.

[7] The amendments to subsections (b), (c), and (e) of Section 122 made by Section 153 of the 1942 Act (*infra*, pp. 77–79) related primarily to the carry-*back* of net operating losses and, by Section 153 (e) of the 1942 Act (*infra*, p. 79) were made effective with respect to taxable years beginning after December 31, 1940.

SEC. 105. TAX ON CORPORATIONS.

* * * * *

(e) *Technical Amendments Made Necessary by Change in Base for Corporate Tax.*—

* * * * *

(3) *Computation of net operating loss deduction.*—Section 122 (relating to net operating loss) is amended to read as follows:

(A) Subsection (a) is amended to read as follows:

"(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)."

(B) Subsection (c) is amended by striking out the parenthesis at the end thereof and inserting in lieu thereof the following: "and without the credit provided in section 26 (e))".

(C) Subsection (d) is amended by striking out "exceptions and limitations" and inserting in lieu thereof "exceptions, additions, and limitations" and by inserting at the end thereof the following new paragraph:

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

SEC. 123. DEDUCTION FOR STOCK AND BOND LOSSES ON SECURITIES IN AFFILIATED CORPORATIONS.

(a) *Stock Losses.*—

(1) *In General.*—Section 23 (g), (relating to capital losses) is amended by inserting at the end thereof the following:

"(4) *Stock in affiliated corporation.*—For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

"(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest, annuities, or gains from sales or exchanges of stocks and securities; and

"(C) the taxpayer is a domestic corporation."

* * * * *

SEC. 150. CAPITAL GAINS AND LOSSES.

* * * * *

(e) *Net Operating Loss Deduction.*—Section 122 (d) (4) is amended to read as follows:

"(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

* * * * *

SEC. 153. TWO-YEAR CARRY-BACK OF NET OPERATING LOSSES.

(a) *Determination of Carry-Back.*—Section 122 (b) (relating to the amount of the net operating loss carry-over), is amended to read as follows:

"(b) *Amount of Carry-Back and Carry-Over.*—

"(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6); and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

"(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4) and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year)."

(b) *Amount of Net Operating Loss Deduction.*—Section 122 (c), relating to the amount of the net operating loss deduction, is amended by inserting in lieu of "amount of the net operating loss carry-over" the following: "aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year."

(c) Section 122 (e) is amended to read as follows:

"(e) *No Carry-Back to Year Prior to 1941.*—As used in this section, the term 'preceding taxable year' and the term 'preceding taxable years' do not include any taxable year beginning prior to January 1, 1941."

* * * * *

(e) *Effective Date.*—The amendments made by this section shall be applicable only to taxable years beginning after December 31, 1940.

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a. Revenue Act of 1943, c. 63, 58 Stat. 21:

SEC. 112. DEDUCTION FOR LOSSES ON SECURITIES IN AFFILIATED CORPORATIONS.

(a) *Stock Losses.*—Section 23 (g) (4) (B) of the Internal Revenue Code (relating to losses on stock of affiliated corporations) is amended to read as follows:

"(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the company in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, or gains from sales or exchanges of stocks and securities; and".

* * * * *

(c) *Taxable Years to Which Applicable.*—The amendments made by this section shall be applicable with respect to taxable years beginning after December 31, 1941.

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